NIAGARA FALLS IN BANKING

by Steve Brown

The Niagara Falls are actually three falls consisting of the American, Luna and Horseshoe (about 90% of the water flows over the Horseshoe). They are not the largest nor the fastest falls in the world, but they are the most visited. Of note, the US owns all or part of all three of the falls, but most of the Horseshoe is owned by Canada. The power of the water flowing through the Niagara Falls is awe inspiring and powerful enough to cause erosion at the base of about 7 miles over the past 10,000 years. If you ask us, visiting the falls is certainly something to put on your bucket list. When it comes to banking, much has been flowing through the industry and many community bankers tell us they feel trapped in a barrel in swirling waters as they worry about what lies downstream. For bankers feeling trapped in a barrel trying to figure out how to launch a decent enterprise risk program, we offer a few suggestions you might want to consider.

To begin, enterprise risk is everyone's responsibility to manage. Just because you anointed someone King or Queen of the risk management kingdom doesn't mean problems have been solved and the bank is now protected against unacceptable risk. To truly protect the bank and develop a game plan that allows managers to operate more effectively, understand that risk is everyone's job to manage.

When it comes to managing risk, as you think about what risks lie right outside your office door, ask what you would do if the risks you thought would be temporary became permanent. People like to have things neatly tied up, but managing risk is a messy business that is constantly changing, so one way to think about things is to challenge yourself and other bank managers to consider the risk you are taking every day in the context of having to hold it to maturity. Asking tough questions such as whether the bank could survive, understanding the impact of each risk and developing a sturdy contingency plan to reduce or eliminate each risk is a great beginning point.

Risk managers should be the type of person that likes to ask lots and lots of questions. Constantly challenging beliefs, assumptions and history are always on this person's mind and they should continually probe to get to a deeper level of risk understanding. Asking such questions as what is the reward we are trying to capture, do we understand the risk we are taking, is this an acceptable risk, what basis/assumptions have we made to determine this risk is acceptable and many others will help refine the process each and every time.

It is also important not to forget that humans are fallible, models are based on assumptions and what you think might happen is probably not how things are going to end up. When your bank teams are having risk management discussions, never forget to challenge predictions and to remind everyone that risk of any sort is not easy to eliminate (usually risks are intertwined, so eliminating one may exacerbate another) to keep everyone thinking about areas where issues may still remain.

Finally, strong risk managers work hard to help everyone understand the downside scenario. If the bank can handle the downside, then fine, but if not - perhaps the bank is getting into a barrel blindfolded and it may not like the ride.

As with Niagara Falls, risk management is never ending, fluid and fast moving, so having a good vantage point and making sure it is on solid ground is a great place to start.

BANK NEWS

Stimulus Help

CBO now estimates that the Stimulus package created some 1.4mm to 3.3mm jobs, lowered the unemployment rate by between 0.7 and 1.8% and increased GDP by between 1.7 and 4.5% (also meaning we are probably in a recession without it)

Rates

According to Market Rates Insight, deposit rates from national banks are now the lowest on record. Rates paid on interest checking, savings, money market and certificates of deposit fell in July to a national average of 0.99%.

TAF Disclosures

As required by Frank-Dodd, the Fed said it will shortly (required by year-end) start releasing names and details of banks that borrowed 2Ys ago under the Term Auction Facility.

Failed Bank Lawsuits

Research finds the FDIC initiated claims against former officers and directors of 24% of institutions that were closed between 1985 and 1992.

Vote of Confidence

Bank of America's CEO, Brian Moynihan, spent nearly $400k this week to purchase 30k shares of stock as it hit a 12 month low. We are not sure of his diversification strategy, but we like the signal.

Cash Holdings

The average Fortune 500 company is holding 11% of their assets in cash as of 2Q, up from a long-term average of 7%.

Housing Sector

A study by real estate information company Trulia finds 27% of renters do not plan to ever buy a home, while 67% of those who are interested in buying a home plan to wait more than 2Ys due to uncertain economic and employment conditions.